technology should be required to make interconnection at such point available to requesting carriers.[26] For example, USTA and Cincinnati Bell express concern that increased efficiency or advances/changes in technology may make a past point of interconnection impractical.[27] These commenters take a narrow reading of the term "points of interconnection." TW Comm concurs with MFS and Teleport that "the Commission should make clear that the reference to 'points' where interconnection has taken place is functional in nature, rather than geographic" and that "a particular point" as used by the Commission for this purpose "refers to all locations having similar characteristics and not to specific geographic locations."[28]

IV. Under Section 252(d)(3), Wholesale Rates for Resale Should Be Set At Retail Rates Less Only Costs That Are Actually Avoided By Providing Service For Resale

As noted by TW Comm in its initial comments and by others, the 1996 Act reflects the intent of Congress that meaningful local service competition will eventuate primarily through the development of competing facilities-based networks and the provision of services over alternative networks, rather than

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[26]Notice at ¶57

[27]Cincinnati Bell Telephone Company Comments at 13; USTA Comments at 16.

[28]Teleport Comments at 23; MFS Communications Company, Inc. Comments at 16.

through the resale or arbitrage of ILEC-provided services. For that reason, it is critical that the "avoided cost" standard governing the pricing of ILEC services available for resale be applied in the manner that Congress drafted that standard, and that states not be free either to require or permit non-cost-based discounted ILEC services for the express purpose of "jump starting" local "competition."

Stated another way, the rates for resold ILEC services should be based solely on the retail rates for those services less those ILEC costs which are, in fact, avoided (*i.e.* not incurred) by offering of those services to a wholesale market (*i.e.* a resale market) rather than a retail market. As Ameritech noted in its comments, ". . . costs that are incurred as a result of making service available on a wholesale basis are not avoided and cannot be excluded in the calculation of just and reasonable wholesale prices."[29] Like TW Comm, Ameritech believes that wholesale rates for resale services should not be artificially depressed by exclusion from the retail service rate of more than actually avoided costs:

> . . . to exclude recovery of any costs incurred in the course of wholesale offerings would encourage inefficient entry and again impede the development of facilities-based

[29]Ameritech comments at 80.

competition.[30]

Some prospective resellers of ILEC services, including AT&T, disagree with that conclusion and have advocated that the Commission sanction artificially discounted wholesale rates with discount levels based on more than avoided costs. While the plain meaning of "avoided costs" is those costs that are actually avoided (*i.e.* not incurred) when ILECs provide service to wholesale rather than retail markets, AT&T would have the Commission require wholesale rates to exclude more than "avoided costs" as required by Section 252(d)(3). AT&T would have the Commission exclude from the retail rates portions of ILECs' shared, common and general overhead costs of the ILECs.[31]

AT&T's desire for artificially subsidized wholesale rates is demonstrated by the broad categories of non-avoided costs which AT&T asks the Commission to include as "avoided costs" for purposes of determining wholesale rate levels. AT&T would exclude as "avoided costs" all of the following cost categories: uncollectibles, marketing expenses, customer service expenses, billing expenses, general support expenses, depreciation expenses, executive and planning expenses, general and administrative expenses, federal income tax, state and local income tax, other

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[30] *Id.*

[31] AT&T comments at 84.

taxes, interest, total returns.[32]

These claims are incredible! Does AT&T seriously contend that ILECs "avoid" uncollectible expenses when providing wholesale service? Certainly, AT&T has incurred uncollectibles in serving resellers. Does AT&T truly believe that a provider of wholesale service does not incur expenses in marketing those services or in billing those services? Does not AT&T pay federal or state income tax on income it earns from its wholesale services? Certainly, AT&T does not deny that all of an ILEC's general and administrative expenses and all of an ILEC's executive and planning expenses are incurred in connection with its retail services and that the entirety of those expenses are avoided in serving the wholesale market. Undoubtedly, AT&T incurs G&A and executive and planning expenses in serving resellers. Why would ILECs not do so as well?

By proposing to exclude virtually all joint, common, and overhead costs from ILEC retail rates, it is clear that AT&T and other proponents of sharply discounted wholesale rates would have the Commission essentially write the "avoided cost" standard out of Section 252(d)(3). AT&T candidly admits as much when it states that discounts should be determined, not with reference to the statutory "avoided cost" standard, but rather that discounts below retail rates should be at levels sufficient to "permit viable

[32] *Id.* at 84 n. 130, n. 131.

competition" irrespective of avoided costs.[33] Stated simply, by proposing that all of the aforementioned ILEC costs be excluded from wholesale rates for the services which AT&T would like to resell, AT&T would have the ILECs' retail customers -- end users -- subsidize AT&T's entry into local service markets.[34]

Finally, the "avoided cost" standard codified at Section 252(d)(3) is the only standard upon which wholesale rates for services to resellers are to be based. Nothing in the 1996 Act supports AT&T's claim that states may permit additional rate discounts to resellers beyond those based on avoided ILEC costs. As the Commission correctly stated in the Notice, the market entry policy embodied in the 1996 Act is "pro-competition, not pro-competitor."[35] To allow states to require non-cost-based discounts of ILEC wholesale services beyond those permitted by the avoided cost standard of Section 252(d)(3) in order to stimulate

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[33]*Id.* at 85. ". . . a discount that does not permit viable competition should be presumed, for purposes of Section 208 complaint proceedings and judicial review of arbitrated and other agreements, not to comply with Sections 251(c)(4) and 252(d)(3)." Further, apparently not content with wholesale rates which exclude virtually all joint, common, and overhead costs, AT&T also asks for non-cost-based "quality of service" discounts (AT&T comments at 85 n. 132).

[34]TW Comm agrees with Ameritech that exclusion of ILEC costs incurred in providing wholesale service in the ILEC wholesale rates would encourage inefficient entry into local markets through resale and would impede the development of facilities-based competition. See Ameritech comments at 80.

[35]Notice at ¶12

competition might benefit certain competitors but it would not promote competition. Apparently lost on AT&T is what resale is about. The key to success in a resale market is the ability of the reseller to perform the retail function (*i.e.* to serve end users) in an efficient manner. Artificially reducing the wholesale price to resellers as proposed by AT&T would enable resellers to offer retail service to end users at lower prices than those charged by producers of the service (*i.e.* the facilities-based network operators), even where the reseller is less efficient in serving the retail market than the facilities-based provider. Indeed, by artificially encouraging arbitrage of ILEC services rather than investment in competing networks, the policy advocated by AT&T and other proponents of non-cost-based wholesale rate discounts would promote continued local market domination by ILECs by protecting their status as the only facilities-based providers in their local service areas. Such a result is fundamentally inconsistent with the 1996 Act and with the pro-competition policies which underlie the 1996 Act.

V. The Pricing Standards Codified At Section 252 of The 1996 Act Require Pricing Of Interconnection, Including Collocation, And Unbundled Network Elements Based Upon TSLRIC, And Prohibit ILEC Recovery Of Residual Or Legacy Costs As Advocated by Certain ILECs

In its initial comments, TW Comm demonstrated that the 1996 Act contains three separate and distinct pricing standards for ILEC facilities and services to be provided to competitors. Which standard applies is dependent on the nature of the ILEC facilities or services sought by the new entrant.

Section 252(d)(1) establishes three requirements governing pricing for interconnection and unbundled network elements. First, those rates are to be "based on cost (determined without reference to rate-of-return or other rate-based proceeding)"; second, they are to be nondiscriminatory; and third, they may include a reasonable profit. TW Comm, like many other commenting parties, explained that the first of these conditions requires a Total Service Long Run Incremental Cost (TSLRIC) pricing standard, while the third condition necessitates a policy determination based upon the nature of the facilities or services provided and, more specifically, the availability of alternative sources for those facilities or services. TW Comm recommended that the Commission promulgate pricing regulations which distinguish those facilities or services which are readily available only from the ILEC from those facilities or services which can either be duplicated by competitors or obtained by competitors from sources other than the ILEC. Facilities and services in the former category would be priced on a TSLRIC standard, which would include "profit" equivalent to capital-related costs. Prices for facilities and services in the latter category could include a reasonable mark-up over TSLRIC reflecting contribution to shared costs and common overheads, consistent that of the ILECs' competitive service offerings.

Section 252(d)(2) establishes the pricing standard for transport and termination. As noted by TW Comm in its initial comments, call termination is the "last bottleneck" in that it will always be an essential element for completion of calls originated on one carrier's network and terminated on another's. For this reason, the 1996 Act allows for reciprocal compensation based upon a "reasonable approximation of the additional cost of terminating such calls."[36] As explained in TW Comm's initial comments, the generally-accepted economic meaning of such "additional" cost is Long Run Incremental Cost (LRIC). In its initial comments and at Section VI of these reply comments, TW Comm explains why a system of bill-and-keep complies fully with Section 252(d) and is the most appropriate means for pricing transport and termination.

Section 252(d)(3) requires that the wholesale prices for ILEC services available for resale must be based on ILEC retail rates charged to end users, excluding "any marketing, billing, collection or other costs that are avoided by the local exchange carrier."[37] As discussed by TW Comm in its initial comments and at Section IV of these reply comments, the proper statutory meaning of "avoided

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[36] 47 U.S.C. §252(d)(2)(A)(ii).

[37] 47 U.S.C. §252(d)(3).

costs" within the ambit of Section 252(d)(3) is limited to those costs which are, in fact, avoided (*i.e.*, not incurred) by ILECs in providing service to wholesale markets rather than to retail markets.

Not surprisingly, most commenting ILECs have totally disregarded the plain language of the 1996 Act in advocating "make-whole" pricing standards that would continue their ability to recover traditional monopoly rents. For example, Ameritech contends that "in adopting national pricing principles, the Commission must ensure that incumbent LECs have the opportunities to recover all costs.[38] Ameritech defines "all costs" as including joint costs, common costs, and residual costs, in addition to TSLRIC. The residual cost category includes historic costs and so-called "legacy" costs, which Ameritech suggests are costs associated with past "regulatory bargains." Lastly, Ameritech contends that "reasonable profits," as used in Section 252 (d)(1)(B), include the opportunity to earn in excess of capital-related costs.

Many of the ILECs' comments include papers prepared by retained economists which discuss the role of economic theory in the pricing practices of competitive firms. These economists support the view that LECs must be able to recover all of their

[38] Ameritech comments at 62.

historic costs from all services, including those services provided to their competitors.[39] What the ILECs seem to have missed, however, is the fundamental issue that differentiates the pricing of interconnection, including collocation, certain unbundled network elements, and transport and termination, from products and services provided in other markets. What is lost in all their discussions is the *nature* of the transactions addressed by Section 252(d), that is, the provision of essential, bottleneck facilities by monopoly firms to their competitors. At the same time, the ILECs also utilize the same network facilities to provide both competitive and non-competitive exchange and exchange access services to end users and interexchange carriers, including services which are to be provided in competition with other firms, including new entrants.

The economic analyses provided by the ILECs are therefore oversimplistic in that they ignore this important dynamic, and the significant incentives it creates for ILECs to exploit their historic market power to shift costs away from their competitive services and onto the essential monopoly services which they are required to provide to their competitors. As pointed out by TW

[39] As discussed below, many of these same economists have been hired by ILECs to justify LRIC price floors for competitive services in the Docket 94-1 Price Cap Review proceedings.

Comm in its comments in the price cap proceeding:

> The relative presence or absence of shared costs among products or among geographic areas directly and substantially influences the possibility for [I]LECs to exert market power, particularly where the products or geographic areas encompass both competitive and non-competitive elements. Indeed, the presence of large shared ... costs argues for the treatment of such underlying facilities as "essential", permitting the competitor to access them on the same favorable terms as the [I]LEC itself enjoys with respect to its competitive services.[40]

It is just such cost shifting that the ILECs have made clear is their purpose. In this proceeding, they assert their right to recover monopoly profits on essential facilities and services provided to competitors, while, in the price cap proceeding, the ILECs have argued for LRIC price floors for competitive services, with virtually no remaining price regulation. Over time, the ILECs would be able to saddle competitors (and other users of non-competitive services) with full recovery of common overheads, and historic "legacy costs," while potentially recovering only direct economic costs from competitive, retail services.

It is precisely because of the incentive for this type of anticompetitive behavior that Congress, in its wisdom, crafted the Section 252(d) pricing standards. As TW Comm explained in its initial comments, the statutory pricing standards for

[40] *Comments of Time Warner Communications Holdings, Inc.*, In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC: Docket No. 94-1, filed December 11, 1995 at 42.

interconnection and unbundled network elements are included in the 1996 Act in recognition of the incentives of incumbent LECs, as providers of essential network facilities and services which are needed by new entrants in order to compete with the ILECs, to use their market power to create entry barriers.

The 1996 Act also recognizes the importance of pricing standards that simulate competitive market conditions where such conditions do not exist. Accordingly, Sections 252(d)(1) establishes TSLRIC as the pricing standard for interconnection and network elements. Contrary to the claims of most ILECs, TSLRIC does not encourage inefficient entry. Rather, TSLRIC represents the forward-looking costs an efficient competitor could expect to incur in entering a competitive local telecommunications market.[41] As such, TSLRIC actually *encourages* efficient entry. By contrast, prices for essential services which include LEC historic costs and monopoly overheads will *discourage* efficient entry by saddling potential new entrants with highly inefficient monopoly costs.[42]

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[41] As discussed in AT&T's comments, properly constructed TSLRIC studies will include all appropriate forward-looking costs that are "causally attributable" to interconnection and network elements.

[42] It is inconsistent for Ameritech to suggest that use of TSLRIC methodology to establish prices for essential facilities and services to be provided to new entrants leads to inefficient entry, while Ameritech and other ILECs have traditionally argued for pricing flexibility with a price floor of TSLRIC on efficiency grounds.

As pointed out by TW Comm and most commenters, the statutory language itself as well as the legislative history clearly prohibit inclusion of embedded rate base costs in the prices for interconnection, including collocation and for unbundled network elements. The soundness of this Congressional policy is underscored by the Time Warner Communications' policy paper entitled "Stranded Investment and the New Regulatory Bargain."[43] The major conclusions of this paper are summarized below with the full text included as Attachment 2 to these reply comments. Those conclusions include the following:

- ILEC arguments that past "regulatory bargains" have caused the economic value of embedded plant to be below its net book value are not supported by an examination of historic market-to-book ratios. While the value of <u>individual</u> capital assets may have eroded, the persistence of premium prices (relative to book value) for LEC shares confirms that investors view the potential opportunities available through competition and reduced regulation as more than offsetting any erosion in value of individual assets.

- LEC management bears full responsibility for any excess plant capacity. Low plant utilization levels, which have been steadily decreasing since the mid-1970's, appear to be wholly related to excess construction due to misforecasting demand for such services as Centrex and second-residential lines, new construction in anticipation of entry into interLATA and video markets, and inadequate outside plant recordkeeping.

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[43] This TW Comm Policy Paper was prepared with the assistance of Dr. Lee L. Selwyn, President of Economics and Technology, Inc., and released in October 1995. See also *Depreciation Policy in the Telecommunications Industry: Implications for Cost Recovery by the Local Exchange Carriers*, Kenneth Baseman and Harold Van Gieson, December 1995.

- The onset of local competition should have been reasonably foreseeable, and should have been reflected in LEC construction planning. Any competitive losses that may occur will be sufficiently gradual so as to afford LECs an ample opportunity to make adjustments to their cost structure to reflect the new market reality.
- The adoption of price caps or other incentive regulation programs de-link rates from costs and terminate the "investment-recovery-and-return" aspects of the "regulatory bargain." Thus, LECs have no entitlement to be "made whole" for competitive losses.

Lastly, Ameritech suggests that the allowed return-on-investment reflected in a TSLRIC methodology as capital-related costs should not be considered "reasonable profit" under the Act. According to Ameritech, "under standard economic principles, the cost of money is considered a cost, rather than profit", because covering the cost of money is necessary to the long-term survival of the firm.[44] Not content with traditional monopoly profits, Ameritech has devised yet another scheme to erect significant entry barriers by price gouging prospective competitors under the guise of "rational economic theory." The notion that the 1996 Act allows ILECs to extract far greater profits from the provision of essential facilities and services to competitors than they were ever permitted to enjoy under rate-of-return regulation is an insult to the framers of the 1996 Act. Such an outrageous notion raises a frightening image of what can be expected if reasonable nationally uniform pricing standards are not promulgated by the

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[44]Ameritech comments at 64.

Commission and enforced by the Commission and by the states.

While it is true that economic theory as applied to pricing and business planning would consider a reasonable return on investment as a necessary long-term expectation, that expectation should not be confused with generally accepted accounting practices. From an accounting standpoint, return on investment is not considered to be a cost, but rather a component of net income. As such, that after-tax amount is available to shareholders for re-investment or for shareholder dividends. In the case of RBOC net income, significant amounts of net income are made available to the regional holding companies for the building of new infrastructure for video services, or for investment in foreign business ventures. The Commission must establish national pricing rules and standards for interconnection, including collocation, and for unbundled network elements that do not allow ILECs to fund such ventures with revenues earned from provision to their competitors of access to essential facilities and monopoly services, particularly while the ILEC services with which new entrants will compete are priced at TSLRIC, or even LRIC

Most commenters simply ignore the difference in language and assert that pricing standards should be the same for transport and termination as for interconnection and network elements. Thus, ILECs argue for full recovery of what is tantamount to fully distributed cost while interexchange carriers advocate recovery of costs based on TSLRIC. Neither of these interpretations is correct. The simple fact is that if Congress had intended the exact same standard to apply both to interconnection and unbundled network elements on the one hand, and reciprocal compensation of transport and termination on the other hand, it would not have included in the 1996 Act a different pricing standard for the former than for the latter. Any national pricing standards adopted by the Commission - or state commissions - must explicitly address and reconcile this difference in statutory language between these two sections. For the reasons discussed in TW Comm's initial comments, the only interpretation of the "additional costs" standard is that of Long-Run Incremental Costs.

VI. Bill-And-Keep Is The Most Appropriate Arrangement For Reciprocal Compensation For The Transport And Termination Of Traffic On Competing LEC Networks

In its initial comments, TW Comm argued that the Commission may, and should, adopt a bill-and-keep compensation mechanism for the reciprocal transport and termination of traffic between competing LECs.[45] TW Comm demonstrated that adopting a bill-and-keep system would (1) facilitate the prompt resolution of interconnection negotiations by eliminating one of the most potentially contentious issues between ILECs and other telecommunications carriers; (2) minimize the opportunity for ILECs

[45] See TW Comm comments at 92-102.

to use the compensation mechanism to impose unnecessary and anticompetitive costs upon new competitors; (3) be administratively simple, resulting in a cost savings to the ILECs and to new competitors; and (4) be economically efficient.

Although this position is shared by numerous commenters, including ALTS,[46] AT&T,[47] Teleport,[48] and DOJ,[49] the RBOCs, GTE and USTA disagree. These ILECs contend that a Commission-mandated bill-and-keep approach is inappropriate because: (1) while bill-and-keep may be implemented through voluntary negotiations, the 1996 Act prohibits the Commission or the states from imposing bill-and-keep; and (2) even if the Commission or the states have the statutory authority under the 1996 Act to require bill-and-keep, doing so would be an unconstitutional "taking" under the Fifth Amendment.

As discussed below, the ILECs misinterpret the 1996 Act and misread well-established constitutional "takings" jurisprudence. A careful review of the 1996 Act and the relevant case law reveals

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[46]ALTS comments at 42-45.

[47]AT&T comments at 69 (proposing "bill and keep" on an interim basis). See also Sprint comments at 87; MCI comments at 52.

[48]Teleport comments at 74 (arguing that "bill and keep" is the most reasonable and efficient transport and termination arrangement.).

[49]DOJ comments at 33-35 (recommending "bill-and-keep" arrangements as an interim, and perhaps permanent, standard for pricing transport and termination).

that the ILECs' arguments are without merit and, as suggested by TW Comm in its initial comments, a bill-and-keep approach should be adopted by the Commission in order to achieve Congress's goal of rapidly establishing competition in the local exchange marketplace.

A. The Commission Has Authority To Implement Bill-And-Keep Pursuant To Section 251(d)(1)

Ameritech claims that "[i]nsofar as waiver [of reciprocal compensation] is a voluntary relinquishment of rights, section 252(d)(2)(B) in no way authorizes either states or the Commission to mandate an arrangement, such as bill-and-keep."[50] Similarly, Bell Atlantic asserts that section 252(d)(2)(B) does not "permit arrangements such as bill-and-keep to be imposed by regulatory mandate."[51] Despite the nearly lockstep protests of these and other ILECs that the Commission lacks the authority to mandate bill-and-keep arrangements,[52] the truth is that there is nothing in the 1996 Act which prohibits the Commission from imposing this type of compensation mechanism for the transport and termination of

[50]Ameritech comments at 78.

[51]Bell Atlantic comments at 41.

[52]See SBC comments at 51 ("Congress has made it clear that no specific interconnection rate structure, including ... bill and keep, can be imposed upon interconnecting carriers."); GTE Service Corp. ("GTE") comments at 56 ("A review of the 1996 Act shows clearly that the FCC has no authority to impose Bill and Keep..."); NYNEX comments at 85 ("... the Commission has no authority to mandate Bill-and-Keep arrangements. Such a compensation method can only be utilized if both parties to the interconnection agreement agree.")

telecommunications traffic.

While TW Comm agrees that Section 252(d)(2)(B) does not expressly require the Commission to impose bill-and-keep, neither does it prohibit the Commission from doing so. Instead, as TW Comm pointed out in its initial comments, the Commission's authority to establish a bill-and-keep compensation scheme is grounded in Section 251(d)(1). Congress provided the Commission with broad authority under Section 251(d)(1) to "complete all actions necessary to establish regulations to implement the requirements" of Section 251, including the reciprocal compensation obligations set forth in 251(b)(5).[53] The ILECs incorrectly focus on a narrow interpretation of Section 252(d)(2)(B) while conveniently ignoring the Commission's regulatory powers and obligations under Section 251(d).

In addition, USTA and certain ILECs argue that mandated bill-and-keep arrangements do not meet the 1996 Act's requirement of the mutual and reciprocal recovery by each carrier of costs associated with transport and termination. For example, USTA states that "[B]ill-and-keep arrangements permit <u>no</u> cost recovery from the originating carrier."[54] Similarly, NYNEX contends that "because bill-and-keep denies the LEC its statutory right to the recovery of

[53]TW Comm comments at 93-95.

[54]USTA comments at 83 (emphasis in original).

its costs associated with transport and termination of traffic, such arrangements cannot be lawfully ordered by regulators."[55]

This line of reasoning disengenuously and incorrectly assumes that bill-and-keep is a system of "free" transport and termination. Nothing could be further from the truth. As explained more fully in TW Comm's initial comments, bill-and-keep is a system of mutual and reciprocal compensation which provides each carrier with a tangible benefit.[56] While not recovering transport and termination costs via a direct cash payment, bill-and-keep permits a LEC to recover its costs through an in-kind benefit; namely, by obtaining access to the other carrier's network for the termination of traffic originated by its customers. Nowhere in the 1996 Act did Congress limit the recovery of costs for terminating telecommunications traffic to cash payments. Accordingly, a bill-and-keep arrangement which does in fact provide compensation and tangible benefit to both carriers, is wholly consistent with the 1996 Act.

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[55]NYNEX comments at 89. See also GTE comments at 57 ("[T]he 1996 Act accords parties a substantive right to recovery of costs [for transport and termination]. If the FCC were to mandate Bill and Keep ... it would trample this substantive right."); BellSouth comments at 73 ("The Act requires that mutual compensation be based on [the recovery] of each carrier's costs to transport and terminate interconnected traffic. Bill-and-keep arrangements do not satisfy this essential predicate of the Act.").

[56]TW Comm comments at 92-93.

B. Bill-And-Keep Does Not Violate The Fifth Amendment

Certain ILEC commenters argue that a Commission-imposed bill-and-keep compensation mechanism would be unconstitutional because it would amount to a taking without just compensation in violation of the Fifth Amendment.[57] This position is fundamentally flawed. To sustain such a claim, a two-prong test must be met. First, it must be established that a "taking" has occurred. Second, it must be established that the "taking" was without "just compensation."[58] As explained below, well-established case law makes it clear that a bill-and-keep system would not implicate either prong of this test.

1. Bill-and-Keep Is Not A Taking Under The Fifth Amendment

Relying on the Supreme Court's decision in Loretto v. Teleprompter Manhattan CATV Corp.,[59] GTE notes that a "permanent physical occupation" is considered a *per se* "taking." GTE further argues that, because a mandated bill-and-keep system would require the physical occupation and use of LEC networks, bill-and-keep must therefore be considered a *per se* taking which requires just

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[57]Bell Atlantic comments at 41; BellSouth comments at 74; GTE comments at 57; USTA comments at 84; US West comments at 70.

[58]See U.S. Const. amend. V.

[59]458 U.S. 419 (1982).

compensation.[60] However, GTE overlooks the fact that in finding permanent physical occupations of property to be *per se* takings, the Loretto court took great pains to distinguish, for purposes of Fifth Amendment analysis, between a permanent occupation and a temporary physical invasion.[61] Whereas a permanent occupation is considered to be a *per se* "taking," a temporary physical invasion is not. A careful examination of the Court's discussion in Loretto demonstrates that bill-and-keep falls far short of a permanent physical occupation of ILEC property.

In describing what constitutes a permanent physical occupation of property, the Loretto Court noted that "[p]roperty rights in a physical thing have been described as the rights 'to possess, use and dispose of it.' To the extent that the government permanently occupies physical property, it effectively destroys each of these rights."[62] Bill-and-keep, which requires only that an ILEC terminate traffic on its network that originated on a competing carrier's network, but still allows full use by the ILEC of its own

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[60]GTE comments at 57. See also BellSouth comments at 74 ("[the] requirement that a LEC transport and terminate traffic of another LEC constitutes a physical intrusion into the LEC's property."); Bell Atlantic comments at 41-41 ("A bill-and-keep arrangement would permit local competitors to occupy the LECs' facilities -- wires and switches -- in much the same way that an easement allows the holder to occupy part of a landowner's property.").

[61]Loretto, *supra* 458 U.S. at 435.

[62]*Id.* at 443. (emphasis added.)

network, in no way destroys (or even inhibits) ILECs from possessing, using or disposing of their own property (*i.e.* their networks). Therefore, since bill-and-keep damages none of these rights, bill-and-keep does not rise to the level of a "permanent physical occupation" and is not a *per se* taking.

In situations involving a physical invasion of property that fall short of a permanent physical occupation (as would be the case with a government-imposed bill-and-keep system), the Loretto court, pointing to Penn Central Transportation Co. v. New York City, acknowledged that a balancing process is appropriate to determine whether a taking has occurred.[63] In Penn Central, the Court acknowledged the absence of a bright line test for determining whether a taking has occurred.[64] Nevertheless, several factors were identified by the Court as having particular significance for evaluating whether a government regulation amounts to a taking. These factors include the following:

(1) the economic impact of the regulation;

(2) the extent to which the regulation has interfered with distinct investment-backed expectations; and

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[63] *Id.* at 433.

[64] 438 U.S. 104, 123-124 (1978) ("... this Court, quite simply, has been unable to develop any "set formula" for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons.").

(3) the character of the government action.[65]

The economic impact of a bill-and-keep system on an ILEC would be, at worst, *de minimis*. As TW Comm noted in its initial comments, bill-and-keep is economically efficient.[66] Traffic between LECs and ILECs is likely to be balanced, the additional cost of terminating traffic on ILEC networks will be close to zero, and the costs associated with measuring traffic and billing between competing LECs would likely outweigh any benefits of doing so. In short, there is no credible evidence in the record to indicate that an ILEC would suffer any adverse economic impact under a mandated bill-and-keep system

Nor does an analysis of the second factor, *i.e.*, the extent to which bill-and-keep will interfere with distinct investment-backed expectations, provide any support for a "takings" claim. While it is true that a statute or regulation may so frustrate distinct investment-backed expectations as to amount to a "taking," such is not the case here. For example, in Pennsylvania Coal Co. v. Mahon,[67] the Court was faced with the question of whether a state statute imposing certain limitations and restrictions on mining would "destroy" rights previously held by the Pennsylvania Coal

[65]*Id.* at 126-127.

[66]TW Comm comments at 97.

[67]260 U.S. 393 (1922).

Company. In holding that a "taking" had occurred, the Court stated:

> To make it commercially impracticable to mine certain coal has very nearly the same effect for constitutional purposes as appropriating or destroying it. This [is what] the statute does.[68]

In contrast, ILECs would suffer no such loss from the adoption of a bill-and-keep system. First, the ILECs' ability to provide telephone services and to derive revenue therefrom would in no way be "destroyed" (or even impaired). Second, potential ILEC revenues for terminating the traffic of competitors would be offset by the savings that would be realized by the ILEC by not having to pay termination fees to competitors for traffic originated on ILEC networks. Moreover, ILECs are complex, multidimensional, international corporations engaged in a wide variety of business enterprises. Assuming *arguendo* that bill-and-keep would result in some level of economic loss, it is simply not credible to think that bill-and-keep would frustrate (or even impact) to any cognizable degree, the "distinct" expectations of ILEC investors.

Evaluating the third factor, the "character" of the government action, also leads to the conclusion that no taking would occur from the implementation of a bill-and-keep system. Instead, as

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[68] *Id.* at 415-416. Pennsylvania Coal has been recognized as the leading case for the proposition that a statute may so frustrate investor expectations as to constitute a taking. See Penn Central, *supra* 438 U.S. at 127.